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UNCLAS SECTION 01 OF 04 DJIBOUTI 000103

SIPDIS

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SUBJECT: 2005 INVESTMENT CLIMATE STATEMENT - DJIBOUTI

1. Summary: Lacking natural resources, Djibouti's economy is service-based, with the country's seaport and a railroad linking it to Addis Ababa accounting for the bulk of economic activity. Almost all food and many other goods are imported from Ethiopia, the Gulf, or France. The services and commercial sectors account for 85 percent of GNP. Telecommunications are reliable, but expensive. Obstacles to foreign investment include bureaucratic apathy, corruption, labor cost and a very slow judiciary system. End Summary

#### Openness to Foreign Investment

2. The government of Djibouti recognizes the crucial need of foreign investment for the economic development of the country. Djibouti's assets include a strategic geographic location, an open trade regime, a stable currency, substantial tax breaks and other incentives. Potential areas of investment include Djibouti's port, tourism, manufacturing and telecom sectors. President Ismail Omar Guelleh has placed privatization, economic reform, and increased foreign investment as top priorities for his government. The president has pledged to seek the help of the international private sector to develop the country's infrastructure.

3. Djibouti has no major laws that would discourage incoming foreign investment. In principle there is no screening of investment or other discriminatory mechanisms. Certain sectors, most notably public utilities, are state owned and are not currently open to investors. IMF requested privatization as a condition for structural adjustment, which led to contracts with Dubai Port International, for the management of the Port of Djibouti (in 2000) and Djibouti International Airport (in 2002). Djibouti Telecom was also handed over to private management to prepare it for an eventual privatization, and although it is not yet privatized, the Railway Company, has already identified several potential investors. Finally, in April 2004, the Government of Djibouti conceded its fishing port to a private firm, Djibouti Maritime Management Investment (DMMI).

4. Created in 2001, the National Investment Promotion Agency (NIPA) promotes investment, facilitates investment operations and works to modernize the country's regulatory framework. The NIPA has been mandated the task of encouraging and facilitating foreign investment by assisting with all administrative procedures. Its ultimate goal is to serve as a one stop shopping center for investors who currently have to deal with several ministries located at various sites in a process with no inter-agency coordination. The NIPA identifies tourism and manufacturing as priority sectors for investment.

5. In 2004, the Ministry of Finances reduced taxes on some products to encourage business sector growth. Automobile spare parts and recording or image producing electronic devices are subject to 8 percent taxes (instead of 33 percent) while taxes on electrical, plumbing or sanitary material decreased to 20 percent from 33 percent. Heavy construction engines and raw cloth are now liable to 8 percent taxes, instead of the previous 20 percent. These tax reforms are meant to promote growth of the construction sector, transportation and textile industry.

6. The most important direct foreign investment in Djibouti remains the project of the Port of Doraleh, which is estimated at a worth of US\$400 million upon completion. Located 8 kms east of the current seaport, the Doraleh Project is intended for third generation container ships and includes an oil terminal, a container terminal and an industrial and commercial free zone financed by Emirates National Oil Company (ENOC) and Dubai Port International (DPI). The first phase of the project, the oil terminal, is already nearing completion. It consists of jetty for tankers and several storage tanks of around 50,000 cubic meters capacity each. A Brazilian company is involved in the construction of the Berth and an Italian company is constructing the storage tanks.

7. Djibouti belongs to a number of regional integration groups and actively promotes the seven-member Inter-governmental Authority on Development (IGAD). It is also part of the Common Market for Eastern and Southern Africa (COMESA), which groups 19 countries into a common market of more than 300 million. Djibouti is an eligible member of

the African Growth and Opportunity Act (AGOA), which grants advantageous access to the United States market. In addition, Djibouti is among the 34 African least developed countries that have the option of entering the European Union Generalized System of Preferences and is a member of the World Trade Organization (WTO).

#### Conversion and Transfer Policies

18. Djibouti has no foreign-exchange restrictions. There are no limitations on converting or transferring funds, or on the inflow and outflow of cash. The Djibouti franc, which has been pegged to the U.S. dollar since 1949, is stable. The fixed exchange rate is 177.71 Djibouti francs to the dollar.

#### Expropriation and Compensation

19. Djibouti Investment Code stipulates "no partial or total, temporary or permanent expropriation will take place without equitable compensation for the damages suffered". The Embassy is not aware of any recent act of expropriation or compensation related to foreign companies. Given the government policy of promoting private investment, none are expected either.

#### Dispute Settlement

10. Djibouti's legal system is based on French law. It consists of three different levels: 1) the First Court ("Premire Instance") where a single judge rules; 2) the Appeals Court ("Cour d'Appel") presided over by three judges; 3) the Supreme Court (Cour Suprme ) mandated to review the proper application of the law in a given trial. The Supreme Court reopens the trial if irregularities are discovered. The system is complex and far from transparent. Government interference in the court system is common. Djibouti has written commercial and bankruptcy laws, but they are not applied consistently. Foreign companies in Djibouti complained about lengthy and biased court deliberations. Judgments by foreign courts are in principle accepted by Djiboutian courts. According to the Ministry of Justice, Djibouti is a member of the International Center for the Settlement of Investment Disputes because any international agreement signed by France before Djibouti gained independence in 1977 is automatically binding in Djibouti. The Chamber of Commerce of Djibouti is planning to set up a Regional Mediation Center, which is designed to settle commercial disputes in a timely and transparent manner.

#### Performance Requirements/Incentives

11. Performance requirements are not a pre-condition for establishing, maintaining, or expanding foreign direct investments. Incentives do, however, increase with the size of the investment and the number of jobs created. Tax benefits and incentives fall under two categories detailed in the investment code. Investments greater than \$280,000 that creates a number of permanent jobs are entitled to exemption from license and registration fees, property taxes, taxes on industrial and commercial profits, and taxes on the profits of corporate entities. Imported raw materials used in manufacturing are exempted from the internal consumption tax. These exemptions apply for up to a maximum of ten years after production commences. Investment matters fall under the jurisdiction of the national investment board, which approves all investments.

13. Djibouti offers significant incentives to private-sector individuals and corporate investors. The Djiboutian investment code guarantees investors the right to freely import all goods, equipment, products, or material necessary for their investments; display products and services; determine and run marketing policy and production; choose customers and suppliers; and set prices. Foreign investors are also free to determine their own hiring and firing policy as long as it remains within the structure of the labor code. A new Labor Code is being finalized to replace the current document, which dates from the French colonial era of 1952.

#### Right to Private Ownership and Establishment

13. Djiboutian laws guarantee the rights for foreign and domestic private entities to establish, own business enterprises and engage in all forms of remunerative activity. Legally established private sector companies have the same access to markets, land ownership, credit, and other business facilities, as do public enterprises. Although restrictions on private enterprises are minimal, competitive equality in regard to public enterprises, namely public utilities, remains limited.

#### Protection of Property Rights

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¶14. Most of the selling of pirated trademarks occurs in the informal market, which represents an important part of the trade in Djibouti. A large share of trade with other countries is also done informally. Djibouti's legal system inherited from the French officially protects the acquisition and disposition of all property rights and safeguards intellectual property, patents, copyrights, trademarks, trade secrets, etc. In addition, Djibouti ratified World Intellectual Property Organization (WIPO) convention, Paris convention on the protection of industrial rights, and Bern convention on the protection of literature and art works. In reality, however, protection of property rights is not enforced.

#### Transparency of the Regulatory System

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¶15. Although the government makes efforts to adopt a transparent policy to foster free enterprise, bureaucratic obstacles and delays are often a problem.

#### Efficient Capital Markets and Portfolio Investment

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¶16. Two large French commercial banks, Indosuez Bank (BIS) and Bank for Commerce and Industry (BCI), dominate the banking system. They account for most deposits but their exposure to the economy is limited to mostly short-term (trade) financing and lending. Credit is allocated on market terms and foreign companies do not face discrimination in obtaining it. However, generally only well-established businesses obtain bank credit, as the cost of credit is high. Both banks offer only a limited array of financial instruments: letters of credit, money transfer, and short and long-term loans.

#### Political Violence

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¶17. Despite past human rights violations and political imprisonments, no significant political violence was reported during 2004, nor was any political opposition figure arrested or detained. The government seems still reluctant to welcome human rights groups and continue to monitor independent unions who are often seen as part of political opposition. One instance of significant police abuse, which resulted in death of a mentally ill Djiboutian, was reported in 2004. A legal investigation was launched into the incident but no notable changes resulted.

#### Corruption

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¶18. Corruption in Djibouti remains a constant encumbrance to investment and business development. While the government officially encourages foreign investment, pressure from government officials to become "partners" with the investor (with no or minimal contribution) and approaching the investor for sub-contracts is common. Foreign businesses complain that establishing an enterprise requires numerous bribes. Also, many business owners chose to bribe Customs Officers to evade taxes. In so doing, they encourage corruption. Corruption poses a major problem in the Court system and results in extreme mistrust by foreign investors.

¶19. While laws against corruption exist, they are rarely enforced. Prosecution and punishment for corruption is rare. Consequently, most people prefer to deal with corruption issues on their own rather than involving the bureaucratic legal system. The Chamber of Accounts and Fiscal Discipline (CAFD), and the State General Inspection have been established to address corruption. The CAFD has the authority to verify and audit all public establishments for transparency and accountability and take necessary legal sanctions. The State General Inspection, another government institution, is designed to complement the work of the CAFD by ensuring that human and material resources in the public sector are properly utilized.

#### Bilateral Investment Agreements

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¶20. Djibouti has several bilateral investment agreements, most notably with Ethiopia and Yemen but also with Egypt, Malaysia and recently with India. Other treaties include: the Partnership Agreement between the Members of the African, Caribbean and Pacific Group of States (ACP); the Agreement for the Promotion, Protection and Guarantee of Investment Among Member States of the Organization of Islamic Conference; Articles of Agreement of the Islamic Corporation for the Insurance of Investment and Export Credit; and the Unified Agreement for the Investment of Arab Capital in the Arab States.

#### OPIC and other Investment Insurance Programs

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¶21. Djibouti is eligible for Overseas Private Investment Corporation (OPIC) programs. OPIC offers up to US\$400 million in combined financial and political risk insurance to eligible U.S. investors.

## Labor

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122. A Law passed in 2000 makes the school compulsory until the age of sixteen. Gross enrollment rates have risen from approximately 38 percent in 1998 to approximately 53 percent in 2003. Vocational or professional training facilities are few, which results in the major problem of lack skilled labor. Employers have also commented that production is low and that it is difficult to find educated and experienced workers. The government remains the main employer but American and French military forces in Djibouti also engage an important number of local workers. By law, all the employers have the obligation to provide social security to their employees. The "Caisse National des Retraites" handles the social security of government workers with long-term contracts, and the "Organisme de Protection Sociale" deal with the private sector and government employees with short-term contracts. Due to the high cost of living, wage levels in Djibouti are among the highest in the region.

123. The Labor Code allows for employees to form labor unions. It also provides guidelines on wages, overtime pay, annual leave, sick leave, work schedules and holidays. A new Labor Code was recently completed and is in the process of being approved by the Parliament; however it is widely contested by the labor unions, which feel that this document gives more rights to employers at the expenses of workers. Two large labor unions exist in Djibouti but the Djiboutian Workers Union (UDT) is the most viable and is recognized by the international organizations. The Government, which has the mandate to act as a mediator between the unions and the employers, regularly interferes with the internal affairs of labor unions.

## Foreign Trade Zones/Free Ports

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123. In 1995 the entire country of Djibouti was designated a free-export processing zone. Any company working exclusively for export in the industrial sector is eligible for the status of Export Processing Company (EPC). In addition, local investors recently developed a free zone with a capacity of up to 100 companies. This small free zone is designed to be a small-scale experiment before establishing the sizable Doraleh industrial and commercial free zone is opened. The Doraleh free zone will cover 600,000 meters squared in the first phase. The Airport, managed by DPI is also planning to establish a free zone within its premises to complement Doraleh Free zone.

## Foreign Direct Investment Statistics (in US\$ million)

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124. The major Foreign Direct Investment (FDI) stays the project of Doraleh, which is reflected in a peak increase in FDI as indicated in the following statistics obtained from the Central bank.

2000: 3.3  
2001: 3.4  
2002: 5  
2003: 21.4